**REPORT ON**
**MULTI-STATE EXAMINATION**
**AS TO THE CONDITION**

**OF**

**SELECTIVE WAY INSURANCE COMPANY**

As of December 31, 2007

NAIC Company Code 26301
NAIC Group Code 0242

## TABLE OF CONTENTS


**SCOPE OF THE EXAMINATION** ..... **1**

**COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS** ..... **3**

**COMPANY HISTORY** ..... **4**

- General Overview ..... 4
- Capital Stock ..... 4
- Dividends to Stockholders ..... 4

**MANAGEMENT AND CONTROL** ..... **5**

- Conflict of Interest Procedures ..... 6
- Corporate Governance ..... 7

**CORPORATE RECORDS** ..... **7**

**PARENT, SUBSIDIARIES AND AFFILIATES** ..... **7**

- Intercompany Agreements ..... 8

**FIDELITY BOND AND OTHER INSURANCE COVERAGE** ..... **9**

**INSURANCE PRODUCTS AND RELATED PRACTICES** ..... **10**

- Territory and Plan of Operation ..... 10

**REINSURANCE** ..... **10**

**ACCOUNTS AND RECORDS** ..... **12**

- Evaluation of Controls in Information Systems (“IS”) ..... 12
- Administrative Offices ..... 13

**FINANCIAL STATEMENTS** ..... **14**

**NOTES TO THE FINANCIAL STATEMENTS** ..... **18**

1. *Statutory Deposits* ..... 18

**SUBSEQUENT EVENTS** ..... **18**

**SUMMARY OF EXAMINATION RECOMMENDATIONS** ..... **18**

**NJDOBI ACTUARIAL OPINION** ..... **19**

**CONCLUSION** ..... **20**

**February 11, 2009**

Honorable Alfred W. Gross, Chairman
Financial Condition (E) Committee, NAIC
Virginia Bureau of Insurance
State Corporation Commission
1300 East Main Street
Richmond, Virginia 23218

Honorable Julie McPeak
Secretary, Southeastern Zone NAIC
Kentucky Office of Insurance
215 West Main Street
Frankfort, Kentucky 40601

Honorable Merle D. Scheiber
Secretary, Midwestern Zone NAIC
South Dakota Division of Insurance
Dept. of Revenue and Regulation
445 East Capital Avenue, 1st Floor
Pierre, South Dakota 57501

Honorable Kent Michie
Secretary, Western Zone NAIC
Utah Department of Insurance
3110 State Office Building
Salt Lake City, Utah 84114

Honorable Steven M. Goldman
Secretary, Northeastern Zone NAIC
New Jersey Dept. of Banking and Insurance
20 West State – CN 325
Trenton, New Jersey 08625

Commissioners:

In compliance with your instructions and pursuant to Insurance Laws and Rules of the State of New Jersey, a comprehensive risk focused examination has been made of the books, records and financial condition of

**Selective Way Insurance Company**
**40 Wantage Avenue**
**Branchville, New Jersey 07890**

hereinafter referred to as the “Company”, “SWIC” or “Selective”. The following examination report as to the condition of the Company is respectfully submitted.

## SCOPE OF THE EXAMINATION

The New Jersey Department of Banking and Insurance, hereinafter referred to as the “NJDOBI” or “We”, have performed a full scope coordinated multi-state risk focused examination of Selective, as the Lead State. The New York and Maine Departments of Insurance participated in this examination. This examination covers the period of January 1, 2003, through December 31, 2007, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination. The principal portion of the examination was conducted at the Company’s statutory home office in Branchville, New Jersey. The Company was last examined by representatives of the NJDOBI as of December 31, 2002. The current examination was conducted concurrent with the examinations of its affiliated companies, Selective Insurance

Company of America (SICA), Selective Insurance Company of New York (SICNY), Selective Insurance of New England (SICNE), and Selective Auto Insurance Company of New Jersey (SAICNJ). During the examination, two of the Company's affiliates, Selective Insurance Company of South Carolina (SICSC) and Selective Insurance Company of the Southeast (SICSE) were in the process of being redomesticated to Indiana. With the approval of the redomestications as of June 30, 2008, the Indiana Department of Insurance will perform its own financial examination of those companies.

We conducted our examination in accordance with the 2007 edition of the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook (the "NAIC Handbook"). The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company. In order to meet these objectives, we obtained information regarding the Company's corporate governance environment, identified and assessed inherent risks to which it is exposed and evaluated its system of internal controls and procedures used to mitigate those risks identified. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

According to the NAIC Handbook, "One of the increased benefits of the enhanced risk-focused approach is to include … consideration of other than financial risks that could impact the insurer's future solvency. By utilizing the enhanced approach, the examiner reviewed the "financial" and "enterprise" risks that existed at the examination "as of" date and will be positioned to assess "financial" and "enterprise" risks that extend or commence during the time the examination was conducted and "prospective" risks which are anticipated to arise or extend past the point of examination completion. Using this approach, examiners will be better positioned to make recommendations for appropriate future supervisory plans (i.e., earlier statutory exams, limited-scope exams, key areas for financial analysts to monitor, etc.) for each insurer."

The Company has adopted an Enterprise Risk Management ("ERM") framework for proactively addressing and mitigating risks, including prospective business risks. The Company's Corporate Governance structure was found to be effective, contributing to its entity level (or monitoring level) controls, including prospective risks. Refer to the "Corporate Governance" section for more detailed information.

KPMG LLP ("KPMG") was retained by the Company to audit its statutory based financial statements as of December 31, 2007 as well as all prior years under examination. In addition to the statutory based financial statements, KPMG audited the Company's financial statements in accordance with accounting principles generally accepted in the United States ("US GAAP"). KPMG also issued reports for all years under examination in relation to the parent company's financial reporting controls as part of its Sarbanes-Oxley ("SOX") reporting. They concluded that the statutory financial statements presented fairly in all material respects, the financial position of the Company at the indicated audit dates and that controls over financial reporting were designed and operating effectively. The examiners performed selected re-testing of KPMG's SOX testing of key internal controls, on a scope basis. Where available, the examiners relied upon the work performed by the independent accountants as prescribed by the NAIC Handbook.

The Company uses the services of the Internal Audit Department ("IAD"), which is independent of management, and serves the Audit Committee of the Board of Directors of Selective Insurance Group, Inc. ("SIGI"), the Company's parent ("the Audit Committee"). The Audit Committee is comprised entirely of external, independent directors). The IAD also assists all levels of management by reviewing and testing financial and operational controls and processes established by management to help ensure compliance with laws, regulations, and company policy.

The Company's SOX testing is performed by the individual business units and the IAD serves primarily in an advisory role regarding SOX compliance efforts. During the course of this examination, consideration was given to the work performed by the business units to comply with SOX. The examiners performed selected re-testing of the Company's business unit SOX testing of key internal controls, on a scope basis. To the extent possible, the examiners relied upon the Company's SOX testing as prescribed by the NAIC Handbook.

All accounts and activities of the Company were considered in accordance with the risk focused examination process. The examination report only addresses regulatory information revealed by the examination process in accordance with the NAIC Handbook. All other financial matters were reviewed and determined not to be material for discussion in this report.

## COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The following recommendations were made in the prior examination report as of December 31, 2002.

1. It is recommended that the Company comply with the requirements of SSAP#63 by reporting the results of all inter-company pooling the same as all other reinsurance.

2. It is recommended that management should continue the process of developing business continuity plans and update them based on the results of testing performed.

3. It is recommended that the Company enter into a custodian agreement with its custodian bank in the format advocated by the NAIC and with the required clauses to protect the Company against any losses due to the actions of the custodian bank.

4. It is again recommended that the Company comply with N.J.S.A 17:24-12 and maintain its securities within the geographical limits of the State of New Jersey.

5. It is recommended that, in the future, the Company have detailed listings, by policy, of what comprises the assets, Agents' balances or uncollected premiums, as shown in the Company's financial statements. Such detailed listings are to be made available to the examiners.

6. It is recommended that the Company discontinue the practice of undisclosed inter-company loans, or execute a formal inter-company loan agreement. This agreement should specify the terms and conditions of any loans, and be submitted for approval to the NJDOBI prior to execution.

During the course of the examination, it was determined that the Company had complied with all of the recommendations stated above.

## COMPANY HISTORY

### General Overview

The Company was incorporated under the laws of the State of New Jersey on April 24, 1973. The charter was filed with the office of the Clerk of Sussex County on April 25, 1973 and was filed with the Department of Insurance of the State of New Jersey on May 2, 1973.

The Company is authorized to engage in the kinds of insurance specified in paragraphs a, b, d, e, f, g, j, k, l, m, and o per N.J.S.A. 17:17-1; and Health Insurance as defined in the Life and Health Insurance Code; N.J.S.A. 17B:1-4; and Legal Services Insurance pursuant to N.J.S.A. 17:46C-4a.(1).

On November 3, 1998, the stockholder approved the Amendment to the Certificate of Incorporation to add a new section eight to permit the Company to issue both participating and nonparticipating policies. This Amendment to Certificate of Incorporation was filed on February 9, 1999.

The Company is a member of an insurance holding company system as defined in N.J.S.A 17:27A-1. Accordingly, the company has registered with the State of New Jersey under the registration filed by its parent, SIGI.

The Company's statutory home office in the State of New Jersey is located at 40 Wantage Avenue, Branchville, New Jersey 07890.

### Capital Stock

The Company has 1,000,000 authorized, issued and outstanding shares with a $5.00 par value per share. SIGI owns 100% of the Company's outstanding capital stock. The Company has no preferred stock outstanding.

### Dividends to Stockholders

New Jersey insurance law provides that, except in the case of extraordinary dividends or distributions, all dividends or distributions paid by the Company may be declared or paid only from unassigned surplus, as determined pursuant to statutory accounting principles, less unrealized investment gains and revaluation of assets.

In addition, the Company must obtain approval from the NJDOBI prior to paying a dividend if the dividend, together with other dividends or distributions made within the preceding twelve months, would exceed the specified statutory limit. The current statutory limitation applicable to New Jersey property and casualty insurers generally is the greater of 10% of the prior calendar year's statutory surplus or the prior calendar year's statutory net gain from operations excluding realized investment gains and losses. Based on the 2006 earnings, there is capacity to pay a dividend of $27.6 million without prior approval from the NJDOBI in 2007. There were no dividends to stockholders declared and unpaid as of the year ended December 31, 2007. The portion of profits on participating policies and contracts is limited pursuant to N.J.S.A. 17B:18-46. The limitations did not restrict the Company's ability to dividend the amounts referenced above.

During the examination period, the Company declared and paid dividends totaling $60.5 million to SIGI. Any extraordinary dividends during the period were approved by the NJDOBI. The dividends were paid as follows:

| Year | | Amount |
|---|---|---|
| 2003 | | $ 4,000,000 |
| 2004 | | 4,000,000 |
| 2005 | | 8,000,000 |
| 2006 | | 17,000,000 |
| 2007 | | 27,500,000 |
| | Total | $60,500,000 |

## MANAGEMENT AND CONTROL

The Company's By-laws state that the number of directors who shall serve on the Board shall be not less than one nor more than 15, the exact number of which shall be fixed from time to time by resolution of the Board. N.J.S.A. 17:27A – 4(d)(3) requires that no less than one-third of the directors be directors who are not officers or employees of the corporation or of any entity controlling, controlled by or under common control with the corporation and who are not beneficial owners of a controlling interest in the voting securities of the corporation or any such entity ("Independent Directors"). N.J.S.A. 17:27A – 4(d) (5) provides that the provisions of paragraphs (3) and (4) of subsection N.J.S.A. 17:27A – 4(d) shall not apply to a domestic insurer if the person controlling the insurer is an entity having a board of directors and committees thereof that substantially meet the requirements of those paragraphs. Selective Insurance Group, Inc. is the parent of the Company and Selective Insurance Group, Inc. has a board of directors and committees thereof that substantially meet the requirements of N.J.S.A. 17:27A – 4(d)(3) and (4). The Company, therefore, was found to be in compliance with these statutes.

The directors of SIGI as of December 31, 2007 were as follows:

| Directors | Principal Occupation |
|---|---|
| Gregory E. Murphy | Chairman of the Board, President and CEO, SIGI |
| Paul D. Bauer | Retired Financial Executive; Former Executive Vice President and Chief Financial Officer, Tops Markets, Inc. |
| W. Marston Becker | Chairman and CEO, Max Capital Group, Ltd. |
| A. David Brown | Senior Vice President, Human Resources, Linens and Things, Inc. |
| John C. Burville | Retired Insurance Consultant to the Bermuda Government. |
| William M. Kearns, Jr. | Chairman and Co-CEO, Keefe Managers, LLC |
| Joan M. Lamm-Tennant | Global Chief Economist and Risk Strategist, Guy Carpenter & Company, LLC |
| S. Griffin McClellan III | Retired Banking Executive |
| Ronald L. O'Kelley | Chairman and CEO, Atlantic Coast Venture Investments Inc. |
| John F. Rockart | Senior Lecturer Emeritus, Massachusetts Institute of Technology |
| William M. Rue | President, Chas. E. Rue & Sons, Inc. t/a Rue Insurance |
| J. Brian Thebault | Chairman, Earth-Thebault |

The executive officers of the Company as of December 31, 2007 were as follows:

| Executive Officer | Title |
|---|---|
| Gregory E. Murphy | Chairman of the Board, President and CEO |
| Richard F. Connell | Senior EVP, Chief Administrative Officer |
| Kerry A. Guthrie | EVP, Chief Investment Officer |
| Dale A. Thatcher | EVP, Chief Financial Officer and Treasurer |
| Ronald J. Zaleski | EVP, Chief Actuary |
| Victor N. Daley | EVP, Human Resources |
| Michael H. Lanza | EVP, General Counsel |
| Mary T. Porter | EVP, Chief Claims Officer |
| John J. Marchioni | EVP, Chief Field Operations Officer |
| Eduard J. Pulkstenis | EVP, Chief Underwriting Officer |
| Sharon R. Cooper | SVP, Director of Communications |

The standing Committees of the Board of Directors of SIGI and the members serving on such committees as of December 31, 2007, were as follows:

**Audit Committee**
Paul D. Bauer, Chairman
Joan M. Lamm-Tennant
John F. Rockart
J. Brian Thebault

**Salary and Employees Benefits Committee**
J. Brian Thebault, Chairman
Paul D. Bauer
John C. Burville
Ronald L. O'Kelley

**Finance Committee**
William M. Rue, Chairman
W. Marston Becker
William M. Kearns, Jr.
S. Griffin McClellan III
Gregory E. Murphy
Ronald L. O'Kelley

**Corporate Governance and Nominating Committee**
A. David Brown, Chairman
William M. Kearns, Jr.
Ronald L. O'Kelley
John F. Rockart

The Audit Committee, Salary and Employee Benefits Committee and Corporate Governance and Nominating Committee of the Board of Directors of SIGI are each comprised entirely of Independent Directors.

## Conflict of Interest Procedures

The Company has a procedure for disclosure to its Board of Directors of any material interest or affiliation on the part of its officers and directors that is in conflict with the official duties of such persons.

Each year, the Company's directors and officers sign a conflict of interest questionnaire and are asked to divulge any potential conflicts of interest that could have an impact on the way they conduct the Company's business.  A review of the conflict of interest questionnaires revealed conflicts were being reported as instructed.

**Corporate Governance**

The Company has adopted an ERM framework for proactively addressing and mitigating risks, including prospective business risks. Exhibit M of the NAIC Handbook was utilized as guidance for assessing corporate governance. Overall, it was determined that the Company's corporate governance structure is effective. The corporate governance framework sets an appropriate "tone at the top," supports a proactive approach to operational risk management, and contributes to an effective system of internal control. It was found that the Board and key executives encourage integrity and ethical behavior throughout the Company and senior management promotes a corporate culture that acknowledges, understands, and maintains an effective control environment.

Management has a strong and effective approach to identifying and mitigating risks across the Company, including prospective business risks. The Company deals proactively with its areas of risk and is knowledgeable about mitigation strategies. Management discusses the significant issues and reacts to changes in the environment with a clear commitment to address risk factors and manage the business accordingly. The Company's overall risk management process is well-defined and takes a proactive approach to identifying, tracking, and dealing with current significant and emerging risk factors.

The IAD is independent of management and reports directly to the Audit Committee. The IAD assists all levels of management by reviewing and testing financial and operational controls and processes established by management to help ensure compliance with laws, regulations, and company policy.

Overall, it was determined that the Company's Internal Audit function is adequate. There are some aspects of a "world class" function in place, but there are areas that need improvement such as ensuring recommendations are implemented and we believe that "high-risk" areas should be reviewed on an annual basis. The Company's SOX testing is performed by the individual business units and the IAD serves primarily in an advisory role regarding SOX compliance efforts. Therefore, the examiners did not rely upon the work performed by the IAD regarding SOX compliance.

## CORPORATE RECORDS

A review was made of the Board minutes and committee minutes for the period of examination. This examination determined that the minutes adequately approve and support the Company's transactions and events. During the review of these minutes, it was determined that the Company directors had reviewed the prior examination report.

## PARENT, SUBSIDIARIES AND AFFILIATES

The Company is a member of an insurance company holding system as defined in N.J.S.A. 17:27A-1 et seq. Accordingly, the Company has filed with the State of New Jersey an insurance holding company registration as is required under N.J.S.A. 17:27A-3.

The following abridged organizational chart at December 31, 2007, identifies the domestic insurance companies within the organization.

Selective Insurance Group, Inc. (non-insurer) (ultimate parent)
- Selective Insurance Company of America (insurer)
- Selective Way Insurance Company (insurer)
- Selective Insurance Company of South Carolina (insurer)
- Selective Insurance Company of New York (insurer)
- Selective Insurance Company of the Southeast (insurer)
- Selective Auto Insurance Company of New Jersey (insurer)
- Selective Insurance Company of New England (insurer)

The Company owed no amounts to its affiliated companies as of December 31, 2007.

**Intercompany Agreements**

Effective July 1, 1995, the Company was a party to a Service Agreement with SICA, (the "Lead Company"), SICSC,and SICSE, with SICNE as an additional signatory on January 1, 2004 and SAICNJ as an additional signatory on July 27, 2006. Under this agreement, the Lead Company performs certain administrative and other services for its affiliates in their operations and makes use of certain properties, equipment, and facilities. The Lead Company allocates these expenses back to its affiliates to be reimbursed based on the percentages set forth in the Amended and Restated Reinsurance Pooling Agreement (see "Reinsurance").

Effective July 1, 2006, the Company entered into an Amended and Restated Reinsurance Pooling Agreement with SICA, SICSC, SICSE, SAICNJ, SICNE and SICNY (collectively called "pool members"). Under this agreement, each pool member cedes 100% of its underwriting activity (net of inuring third party reinsurance) to the Lead Company. See "Reinsurance" for further details.

Effective July 1, 1995, the Company entered into a Tax Allocation Agreement which covers the allocation, settlement and financial statement presentation of current federal income taxes among companies in the consolidated income tax return of SIGI and its subsidiaries.

Effective July 1, 1995, the Company entered into a Joint Investment Operations Agreement with SICA. Under this agreement, SICA will incur and pay expenses, disburse, collect and pay monies and undertake any and all other activities involving the operation of such joint investment operations on behalf of the affiliated companies. The Company shall reimburse SICA for its expenses, costs and other items incurred with the joint investment operations to be allocated in the same proportion that the investable assets of each company bears to the total sum of all the assets.

Effective June 1, 2006, the Company entered into an Intercompany Demand Revolving Loan Agreement with SICA, SAICNJ, SICSC, SICSE and SICNE. Under this agreement, SICA agrees to lend amounts to the parties to the agreement as they may request, provided that the total outstanding principal amount of loans shall be in SICA's sole discretion and shall at no time exceed 5% of SICA's admitted assets as of December 31 of the preceding calendar year. The borrowing parties promise to repay SICA on demand. Interest on the loans is to be paid monthly at the Federal Funds Effective Rate.

## FIDELITY BOND AND OTHER INSURANCE COVERAGE

As of December 31, 2007, the Company is covered by a fidelity bond with Federal Insurance Company and has a single loss limit of $5 million and an aggregate limit of liability of $10 million shared with its affiliates.

As of December 31, 2007, the Company is also party to an insurance program whereby its parent, SIGI, has purchased policies to protect itself and its subsidiaries in the following areas, as applicable:

Property - policy provides protection for buildings and contents, business income, earthquake and inland marine coverage. It is underwritten by the Company and has the following limits:

- Building & Business Personal Property - $111,563,314
- Business Income - $24,305,000
- Difference In Conditions - $50,000,000
- Inland Marine - $24,305,000

Boiler & Machinery - provided by Hartford Steam Boiler Co. with a limit of $100 million.

Workers' Compensation - provided by Selective Insurance Company of South Carolina for all Selective employees except those in NE, CA, FL, MA and TX. Coverage for those states is provided by Chubb Insurance Company. Both policies provide the following limits:

- Workers' Compensation - statutory requirements
- Employers' Liability - $1 million each accident, $1 million policy limit and $1 million each employee.

Directors & Officers - total of 10 layers providing a total limit of $100 million with an additional $30 million of Side A coverage. There are 9 carriers that provide the 10 layers of coverage.

Fiduciary Liability - provided by Travelers Insurance Company with a limit of $15 million.

Pollution Liability - provided by Zurich American Insurance Company with limits of $2 million each claim and $2 million total of all claims.

General Liability - provided by the Company with limits of $2 million each occurrence and $3 million aggregate.

Automobile Liability - provided by the Company with a $2 million combined single limit.

Professional Liability, Errors & Omissions - provided by Selective Insurance Company of America with a $17 million limit of liability per claim and in the aggregate.

Commercial Umbrella Liability - first layer provided by the Company with a limit of $15 million; second layer provided by Ohio Casualty Insurance Company with a limit of $25 million in excess of $15 million.

Employment Practices Liability - provided by ACE Westchester Fire Insurance Company with an aggregate limit of liability of $10 million.

ERISA Bond - provided by Federal Insurance Company with a $3 million limit of liability.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

The Company is 100% owned by SIGI. SIGI is a publicly traded stock company. The parent is an insurance holding company, which through its insurance subsidiaries writes a broad range of property and casualty insurance products.

The Company is a regional company providing a broad range of insurance and alternative risk management products and services to businesses, public entities and individuals, through a number of independent agents in 10 Eastern and Midwestern states.

The Company is licensed in Delaware, District of Columbia, Georgia, Maryland, Michigan, New Jersey, New York, Pennsylvania, South Carolina and Virginia.

The Company has organized its business around its customers, developing and marketing its products through Strategic Business Units (SBUs). SBUs cut across insurance lines and functions to focus on meeting and exceeding the needs of its specific customer group. This approach allows the Company to both identify new business opportunities and efficiently track and correct under-performing business classes.

The SBUs provide a wide variety of support services to the Company's field operations and agents. These supporting services include analyzing underwriting results, developing programs to improve profitability in under performing business classes, establishing underwriting and quality control standards, designing marketing campaigns and conducting technical training programs.

The Company is committed to the independent agency system and works closely with agents and field underwriters to identify new business opportunities and to develop and market products.

## REINSURANCE

Reinsurance Agreements with Affiliates

The Company participates in a Reinsurance Pooling Agreement. Under this agreement, each pool member cedes 100% of its underwriting activity (net of inuring third party reinsurance) to the Lead Company. The remaining net underwriting activity is retroceded to each pool member in accordance with each company's pooling percentage as set forth in the Amended and Restated Reinsurance Pooling Agreement.

The pooled percentages as of December 31, 2007, by Company are as follows:

- Selective Insurance Company of America – 49.5%
- Selective Way Insurance Company – 21%
- Selective Insurance Company of the Southeast – 7%
- Selective Insurance Company of South Carolina – 9%
- Selective Insurance Company of New York – 7%
- Selective Auto Insurance Company of New Jersey – 6%
- Selective Insurance Company of New England – 0.5%

Reinsurance Agreements with Non-Affiliates

The Company assumes required business from its participation in various voluntary and involuntary pools.

The Company had the following reinsurance program in effect at December 31, 2007:

**CASUALTY**
**2007 Workers Compensation and Casualty Excess of Loss Treaty (various reinsurers)**

| | Maximum Retention Each Occurrence | Reinsurance Limit Each Occurrence | Total Limits |
|---|---|---|---|
| Workers Compensation Only | $2,000,000 | $3,000,000 | $5,000,000 |
| First Casualty Layer | $5,000,000 | $7,000,000 | $12,000,000 |
| Second Casualty Layer | $12,000,000 | $9,000,000 | $21,000,000 |
| Third Casualty Layer | $21,000,000 | $9,000,000 | $30,000,000 |
| Fourth Casualty Layer | $30,000,000 | $20,000,000 | $50,000,000 |
| Fifth Casualty Layer | $50,000,000 | $40,000,000 | $90,000,000 |

The Company or its affiliates, as the case may be, retains 25% share of the reinsurance limit for the fourth layer. The Company or its affiliates, as the case may be, retains first $2 million per risk for workers compensation only and $5 million per risk all other casualty lines.

**PROPERTY**
**2007 Property Excess of Loss Treaty (various reinsures)**

| | Maximum Retention Each Occurrence | Reinsurance Limit Each Occurrence | Total Limits |
|---|---|---|---|
| First Layer | $2,000,000 | $8,000,000 | $10,000,000 |
| Second Layer (A) | $10,000,000 | $15,000,000 | $25,000,000 |

The second layer (B) is for policies written on a blanket limit. There is an additional $5 million each loss and each occurrence in excess of $25 million provided under Section A of second layer. Company retains first $2 million per risk.

**2007 Property Catastrophe Excess of Loss (various reinsurers)**

| | Maximum Retention Each Occurrence | Reinsurance Limit Each Occurrence |
|---|---|---|
| First Layer | $40,000,000 | $100,000,000 |
| Second Layer | $100,000,000 | $175,000,000 |
| Third Layer | $175,000,000 | $325,000,000 |
| Fourth Layer | $325,000,000 | $375,000,000 |

Each layer is subject to a 5% co-participation by the Company or its affiliates, as the case may be. The total program provides for 95% of $335 million in excess of a $40 million retention or $334.5 million ground up limit net of co-participation.

**OTHER REINSURANCE**
**2007 Surety and Fidelity Excess of Loss**

| | Maximum Retention Each Occurrence | Reinsurance Limit Each Occurrence | Total Limits |
|---|---|---|---|
| First Layer | $1,000,000 | $3,000,000 | $4,000,000 |
| Second Layer | | | |
| Contract Surety | $4,000,000 | $5,000,000 | $9,000,000 |
| Commercial Surety | $4,000,000 | $2,000,000 | $6,000,000 |

Company retains the first $1 million and 10 percent co-participation of each layer.

## ACCOUNTS AND RECORDS

**Evaluation of Controls in Information Systems ("IS")**

The IS portion of the examination was performed in accordance with the NAIC Handbook. The review of IS controls included IS management and organizational controls; application and operating system software change controls; system and program development controls; overall systems documentation; logical and physical security controls; contingency planning; local and wide area networks, and mainframe controls.

The Information Technology ("IT") examination team prepared a "Risk Universe" which compared the Company's IT key SOX controls to the COBIT framework, a widely-accepted control framework for information technology. This Risk Universe tool mapped the Company's controls to the COBIT objectives and the Company's external auditor's work. This key tool allowed the examiners to determine gaps in potential coverage. The IT examination team performed a "desk review" of the work of the Company's IT workpapers (i.e., the Business Application Profiles and SOX Folders for 2005 and 2006 as well as the external auditors, KPMG) to assess quality of work and thoroughness of testing.

The IT examination team also reviewed relevant work performed by the Company's internal auditors (i.e., in-house internal auditors or PricewaterhouseCoopers, the Company's outsourced vendor assisting with internal audits). The result of this extensive desk review resulted in the IT examination team concluding that adequate testing/coverage has been performed by these 3 key groups. This desk review, plus the review of the NAIC Handbook Exhibit C documents, constituted the bulk of the work performed by the examiners related to IT risks and controls.

As a result of the procedures performed, the IT Examination Team obtained reasonable assurance that IT general controls and general application controls were functioning as management intended and that an effective system of controls is in place and conducive to the accuracy and reliability of financial information processed and maintained by the Company. There are no reportable items related to our review of IS controls.

## Administrative Offices

While the primary management and financial reporting activities and the Northeast region operations are conducted from the Home Office in Branchville, New Jersey, the Company maintains other administrative offices, including the following as of December 31, 2007:

- Parsippany, NJ – Investments
- Glastonbury, CT – Information Systems
- Richmond, VA – Claims Service Center
- Charlotte, NC – Southern region field office
- Columbus, OH – Great Lakes region field office
- Hamilton, NJ – New Jersey region field office
- Allentown, PA – Mid-Atlantic region field office
- Carmel, IN – Heartland region field office

## FINANCIAL STATEMENTS

| Net Admitted Assets as of December 31, | 2007 | 2003 |
|---|---|---|
| Bonds **NOTE 1** | $ 626,158,200 | $ 417,719,759 |
| Preferred stocks | | 10,412,500 |
| Common stocks | 79,657,935 | 47,723,392 |
| Cash & cash equivalents | 192,733 | |
| Short-term investments | 9,337,304 | 118,403 |
| Other invested assets | 20,418,532 | 28,726 |
| Receivables for securities | 92,209 | - |
| Subtotal cash and invested assets | 735,856,913 | 476,002,780 |
| Investment income due and accrued | 7,750,695 | 5,807,783 |
| Premiums and considerations: | | |
| Uncollected premiums and agents' balances in the course of collection | 39,772,972 | 85,071,944 |
| Deferred premiums and agents' balances and installments booked but | | |
| deferred and not yet due | 84,154,149 | 65,306,303 |
| Accrued retrospective premiums | 1,037,066 | 902,265 |
| Reinsurance: | | |
| Amounts recoverable from reinsurers | 15,740,377 | 47,339,308 |
| Other amounts receivable under reinsurance contracts | | 12,783,412 |
| Net deferred tax asset | 18,058,274 | 15,787,587 |
| Guaranty funds receivable or on deposit | 471,642 | 120,116 |
| Receivable from parent, subsidiaries and affiliates | 14,209,468 | 22,939,404 |
| Aggregate write-ins for invested assets | 5,532,916 | 2,553,734 |
| **Total Net Admitted Assets** | $ 922,584,472 | $ 734,614,636 |

## FINANCIAL STATEMENTS (Continued)

| **Liabilities as of December 31,** | **2007** | **2003** |
|---|---|---|
| Losses | $ 410,331,518 | $ 261,413,078 |
| Reinsurance payable on paid losses and loss adjustment expense | 11,892,246 | 36,742,942 |
| Loss adjustment expenses | 75,206,437 | 40,486,850 |
| Commissions payable, contingent commissions or similar charges | 12,637,362 | 11,549,084 |
| Other expenses | 9,368,276 | 6,734,602 |
| Taxes, licenses and fees due or accrued | 5,578,022 | 4,937,017 |
| Current federal and foreign income taxes | 495,694 | 1,855,971 |
| Unearned premiums | 159,424,778 | 128,378,582 |
| Advance premium | 697,885 | 502,068 |
| Dividends declared and unpaid policyholders | 1,186,677 | 609,309 |
| Ceded reinsurance premiums payable | 33,672,184 | 85,573,864 |
| Funds held by company under reinsuranc treaties | | 4,995 |
| Amounts withheld or retained by company for account of others | 867,621 | 603,911 |
| Provision for reinsurance | 709,707 | 2,238,870 |
| Aggregate write-ins for liabilities | 416,050 | 17,112,260 |
| **Total Liabilities** | $ 722,484,457 | $598,743,403 |

## FINANCIAL STATEMENTS (Continued)

| **Capital and Surplus as of December 31,** | **2007** | **2003** |
|---|---|---|
| Common capital stock | $ 5,000,000 | $ 5,000,000 |
| Gross paid in and contributed surplus | 18,611,000 | 15,611,000 |
| Unassigned funds (surplus) | 176,489,015 | 115,260,233 |
| **Total Capital and Surplus** | 200,100,015 | 135,871,233 |
| **Total Liabilities, Capital, and Surplus** | $ 922,584,472 | $ 734,614,636 |

## FINANCIAL STATEMENTS (Continued)

| **Summary of Operations for the Year Ended December 31,** | **2007** | **2003** |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | $ 323,777,233 | $ 247,168,079 |
| Deductions: | | |
| Losses incurred | 177,189,342 | 148,087,640 |
| Loss expenses incurred | 35,542,993 | 26,701,120 |
| Other underwriting expenses incurred | 104,647,061 | 80,011,956 |
| Aggregate write-ins for underwriting deductions | 83,369 | 924,725 |
| Total underwriting deductions | 317,462,765 | 255,725,441 |
| Net underwriting gain (loss) | 6,314,468 | (8,557,362) |
| Investment Income | | |
| Net investment income earned | 31,733,337 | 22,813,315 |
| Net realized capital (losses) or gains | (241,629) | 2,301,458 |
| Net investment gain | 31,491,708 | 25,114,773 |
| Other Income | | |
| Net loss from agents' or premium balances charged off | (594,512) | (376,274) |
| Finance and service charges not included in premiums | 899,144 | 562,223 |
| Aggregate write-ins for miscellaneous income | 80,351 | 195,417 |
| Total other income | 384,983 | 381,366 |
| Net income before dividends to policyholders and before federal and foreign income taxes | 38,191,159 | 16,938,777 |
| Dividends to policyholders | 1,512,391 | 1,086,527 |
| Net income after dividends to policholders but before federal and foreign income taxes | 36,678,768 | 15,852,250 |
| Federal and foreign income taxes incurred | 10,930,793 | 5,661,000 |
| **Net Income** | 25,747,975 | 10,191,250 |

## FINANCIAL STATEMENTS (Continued)

| **Changes in Capital and Surplus for the year ended December 31,** | **2007** | **2006** | **2005** | **2004** | **2003** | **2002** |
|---|---|---|---|---|---|---|
| **Surplus as regards policyholders, December 31, Previous Year** | $ 201,660,250 | $ 182,688,802 | $ 161,699,453 | $ 135,871,233 | $ 114,302,650 | $ 122,235,830 |
| Net income (loss) | 25,747,975 | 28,529,832 | 28,783,527 | 25,152,803 | 10,191,250 | 7,449,980 |
| Change in net unrealized gains or (losses) | (514,013) | 3,364,935 | (1,097,511) | 3,802,991 | 8,797,191 | (11,840,102) |
| Change in net deferred income tax | 2,210,414 | 2,272,531 | 1,921,281 | (1,750,605) | 1,334,468 | 2,766,477 |
| Change in non-admitted assets | (2,733,947) | 1,544,788 | (334,045) | (2,143,140) | 3,537,188 | (636,514) |
| Change provision for reinsurance | (402,171) | 259,362 | (154,528) | 1,826,500 | (1,198,853) | (473,021) |
| Surplus adjustments paid in | | | | 3,000,000 | 3,351,000 | - |
| Dividends to stockholders | (27,500,000) | (17,000,000) | (8,000,000) | (4,000,000) | (4,000,000) | (5,200,000) |
| Aggregate write-ins for gains and losses in surplus | 1,631,507 | | (129,375) | (60,329) | (443,661) | - |
| Net change in capital and surplus for the year | (1,560,235) | 18,971,448 | 20,989,349 | 25,828,220 | 21,568,583 | (7,933,180) |
| **Capital and surplus, December 31, Current Year** | $ 200,100,015 | $ 201,660,250 | $ 182,688,802 | $ 161,699,453 | $ 135,871,233 | $ 114,302,650 |

## NOTES TO THE FINANCIAL STATEMENTS

The examination of the Company's financial position as of December 31, 2007, resulted in the following notes and comments that are deemed to require special explanation or description.

1. *Statutory Deposits*

As of December 31, 2007, the Company is maintaining statutory deposits with the following jurisdictions:

| Jurisdiction | Description of Deposit | Book/Adjusted Carrying Value | Fair Value |
|---|---|---|---|
| Delaware | US Treasury Notes | $ 140,700 | $ 170,059 |
| Georgia | US Treasury Notes | 84,420 | 102,035 |
| New Jersey | US Treasury Notes | 1,125,600 | 1,360,470 |
| Virginia | US Treasury Notes | 84,420 | 102,035 |
| | **Totals** | $1,435,140 | $1,734,599 |

As of December 31, 2007, the deposits held by the State of New Jersey, the Company's state of domicile, are held for the benefit of all policyholders. All other deposits are held for the benefit of specific jurisdictions and limited groups of policyholders.

## SUBSEQUENT EVENTS

The subsequent events period considered for the examination was December 31, 2007 through the date of the examination report incorporated herein.

In February 2008, SICA announced a reduction in its workforce of approximately 80 positions. These changes are anticipated to have a related one-time pre-tax pooled cost of approximately $0.8 million in the first quarter of 2008 and annualized pre-tax pooled savings of approximately $1.5 million.

## SUMMARY OF EXAMINATION RECOMMENDATIONS

The full scope coordinated multi-state risk focused examination of the Company yielded no reportable recommendations.

## LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES – STATEMENT BY NJDOBI ACTUARY

Selective Way Insurance Company

I, Boris Privman, FCAS, MAAA, Managing Property and Casualty Actuary for the New Jersey Department of Banking and Insurance, have performed an actuarial review of the Reported December 31, 2007 loss and loss adjustment expense reserves for Selective Way Insurance Company. Based upon this review the Company's booked gross and net loss reserves should be accepted without adjustments.

Actuarial findings as stated above and in this examination report are the sole responsibility of the New Jersey Department of Banking and Insurance's Property and Casualty Actuarial Unit of the Office of Solvency Regulation.

/S/

Boris Privman – Managing Actuary

# CONCLUSION

The undersigned hereby certify that an examination has been made of the **Selective Way Insurance Company** and the foregoing report is true to the best of our knowledge and belief.

Respectfully submitted,

____________/S/____________
Rachelle Gowins, CFE
Examiner-In-Charge
Representing the State of New Jersey

Under the Supervision of

____________/S/____________
Robert Redden, CFE
Reviewer
Representing State of New Jersey

State of Texas
County of Collin

Subscribed and sworn to before me, Patrick Cory Mock, on this 17th day of February, 2008.

____________/S/____________
Patrick Cory Mock
Notary Public of Texas

My commission expires: April 29th, 2012